
Financial Statements

Avalon Rare Metals Inc.
(formerly Avalon Ventures Ltd.)

For the Six Months Ended February 28, 2009

Unaudited - See Notice to Reader

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NOTICE TO READER

The accompanying unaudited interim financial statements have been prepared by the Company's management and the Company's independent auditors have not performed a review of these financial statements.

Avalon Rare Metals Inc.

(formerly Avalon Ventures Ltd.)

Balance Sheets

As at February 28, 2009 and August 31, 2008

Unaudited - See Notice to Reader

	February 28, 2009	August 31, 2008
Assets		
Current Assets		
Cash and cash equivalents	\$ 8,488,834	\$ 10,738,700
Receivables	133,647	152,165
Prepaid expenses	104,866	130,226
	<u>8,727,347</u>	<u>11,021,091</u>
Investments Available for Sale	3,943	3,943
Resource Properties (note 4)	16,244,902	13,188,626
Property, Plant and Equipment	<u>145,696</u>	<u>170,930</u>
	<u>\$ 25,121,888</u>	<u>\$ 24,384,590</u>
Liabilities		
Current Liabilities		
Accounts payable	<u>\$ 975,644</u>	<u>\$ 892,806</u>
Shareholders' Equity		
Share Capital (note 5)	44,530,885	43,273,243
Contributed Surplus (note 6)	217,819	54,175
Deficit	(20,594,260)	(19,827,434)
Accumulated Other Comprehensive Loss	<u>(8,200)</u>	<u>(8,200)</u>
	<u>24,146,244</u>	<u>23,491,784</u>
	<u>\$ 25,121,888</u>	<u>\$ 24,384,590</u>

Approved on behalf of the Board

_____, "Donald S. Bubar", Director

_____, "Brian MacEachen", Director

Avalon Rare Metals Inc.

(formerly Avalon Ventures Ltd.)

Statements of Operations and Deficit

For the Periods Ended February 28, 2009 and February 29, 2008

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	Six Months Ended		Three Months Ended	
	February 28, 2009	February 29, 2008	February 28, 2009	February 29, 2008
Revenue				
Interest income	\$ 96,947	\$ 163,758	\$ 52,701	\$ 141,359
Expenses				
Amortization	25,234	11,969	12,618	6,720
Consulting fees	34,813	19,773	32,788	18,010
Directors' fees	20,000	20,000	9,000	11,000
Insurance	26,682	20,564	13,773	10,776
Interest and financing costs	12,312	29,213	9,865	21,475
Office and general	15,948	17,240	10,934	11,382
Professional fees	110,309	86,701	77,383	58,701
Public and investor relations	236,593	237,033	118,981	151,512
Rent and utilities	53,029	53,264	26,927	27,305
Salaries and benefits	308,250	345,218	146,688	236,618
Shareholders' information	19,424	21,483	18,141	21,483
Stock-based compensation	300,036	281,952	164,987	139,267
Transfer and filing fees	52,885	197,855	32,208	193,277
Travel	53,258	85,467	22,073	31,244
	<u>1,268,773</u>	<u>1,427,732</u>	<u>696,366</u>	<u>938,770</u>
Loss before the Undernoted Item	(1,171,826)	(1,263,974)	(643,665)	(797,411)
Recoveries of Resource Properties	-	10,000	-	10,000
Loss before Income Taxes	(1,171,826)	(1,253,974)	(643,665)	(787,411)
Future Income Tax Recoveries (note 7)	405,000	1,373,500	405,000	-
Net Income (Loss) for the Period	(766,826)	119,526	(238,665)	(787,411)
Deficit - Beginning of Period	(19,827,434)	(18,435,853)	(20,355,595)	(17,528,916)
Deficit - End of Period	<u>\$ (20,594,260)</u>	<u>\$ (18,316,327)</u>	<u>\$ (20,594,260)</u>	<u>\$ (18,316,327)</u>
Loss per Share, basic and fully diluted	<u>\$ (0.01)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (0.01)</u>
Weighted Average Number of Common Shares Outstanding, basic and fully diluted	<u>65,962,165</u>	<u>58,724,387</u>	<u>67,289,165</u>	<u>63,920,072</u>

Avalon Rare Metals Inc.

(formerly Avalon Ventures Ltd.)

Statements of Comprehensive Income (Loss)

For the Periods Ended February 28, 2009 and February 29, 2008

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	<u>Six Months Ended</u>		<u>Three Months Ended</u>	
	<u>February 28, 2009</u>	<u>February 29, 2008</u>	<u>February 28, 2009</u>	<u>February 29, 2008</u>
Net Income (Loss) for the Period	\$ (766,826)	\$ 119,526	\$ (238,665)	\$ (787,411)
Other Comprehensive Income	-	-	-	-
Comprehensive Income (Loss) for the Period	<u>\$ (766,826)</u>	<u>\$ 119,526</u>	<u>\$ (238,665)</u>	<u>\$ (787,411)</u>

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(formerly Avalon Ventures Ltd.)

Cash Flow Statements

For the Periods Ended February 28, 2009 and February 29, 2008

Unaudited - See Notice to Reader

	<u>Six Months Ended</u>		<u>Three Months Ended</u>	
	<u>February 28,</u> <u>2009</u>	<u>February 29,</u> <u>2008</u>	<u>February 28,</u> <u>2009</u>	<u>February 29,</u> <u>2008</u>
Cash Flows from Operating Activities				
Cash paid to suppliers and employees	\$ (965,547)	\$ (943,782)	\$ (465,826)	\$ (765,982)
Interest received	96,947	163,758	52,701	141,359
Interest paid	(73,969)	(45,273)	(73,969)	(45,273)
	<u>(942,569)</u>	<u>(825,297)</u>	<u>(487,094)</u>	<u>(669,896)</u>
Cash Flows from Financing Activities				
Share capital - private placement	1,400,625	15,527,155	1,400,625	-
Share capital - exercise of warrants	-	1,317,769	-	961,900
Share capital - exercise of options	125,625	176,000	125,625	80,000
	<u>1,526,250</u>	<u>17,020,924</u>	<u>1,526,250</u>	<u>1,041,900</u>
Cash Flows from Investing Activities				
Resource property expenditures	(2,833,547)	(1,903,373)	(859,521)	(855,575)
Recoveries of resource properties	-	10,000	-	10,000
Purchase of plant, property and equipment	-	(36,348)	-	(30,499)
	<u>(2,833,547)</u>	<u>(1,929,721)</u>	<u>(859,521)</u>	<u>(876,074)</u>
Change in cash and cash equivalents	(2,249,866)	14,265,906	179,635	(504,070)
Cash and cash equivalents				
- beginning of period	<u>10,738,700</u>	<u>1,562,102</u>	<u>8,309,199</u>	<u>16,332,078</u>
Cash and cash equivalents				
- end of period	<u>\$ 8,488,834</u>	<u>\$ 15,828,008</u>	<u>\$ 8,488,834</u>	<u>\$ 15,828,008</u>

Avalon Rare Metals Inc.

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Notes to the Financial Statements

For the Six Months Ended February 28, 2009

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1. Accounting Policies

These interim financial statements have been prepared by the Company in accordance with Canadian generally accepted accounting principles. These financial statements are based on accounting principles and practices consistent with those used in the preparation of the Company's annual financial statements except for the changes made to adopt the new accounting standards as described in the following paragraph. Certain information and note disclosure normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. These interim financial statements should be read together with the audited financial statements and the accompanying notes of the Company for the year ended August 31, 2008.

New Accounting Policies

On September 1, 2008, the Company adopted three new accounting standards issued by the CICA: Handbook Section 1535, "Capital Disclosures", Handbook Section 3862, "Financial Instruments – Disclosures", and Handbook Section 3863, "Financial Instruments – Presentation". The Company has applied these new standards on a prospective basis.

Capital Disclosures

Handbook Section 1535 requires disclosure of an entity's objectives, policies and process for managing capital, quantitative data about what the entity regards as capital and whether the entity has complied with any capital requirements and, if it has not complied, the consequences of such non-compliance. The Company has included disclosures recommended by this new Handbook section in note 2.

Financial Instruments – Disclosures

Handbook Section 3862 requires an entity to provide disclosures to enable users to evaluate the significance of financial instruments for an entity's financial position and performance, including disclosures about fair value. In addition, disclosure is required of qualitative and quantitative information about the nature and extent of risks arising from financial instruments, including specified minimum disclosures about liquidity risk and market risk. The quantitative disclosures must also include a sensitivity analysis for each type of market risk to which an entity is exposed, showing how net income and other comprehensive income would have been affected by reasonably possible changes in the relevant risk variable. The Company has included disclosures recommended by this new Handbook section in note 3.

Financial Instruments – Presentation

Handbook Section 3863 replaces the existing requirements on presentation of financial instruments which have been carried forward unchanged to this new section. The adoption of this standard did not have any impact on the presentation of the Company's financial statements.

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2. Capital Disclosures

The Company includes equity, comprised of share capital, contributed surplus and deficit in the definition of capital.

The Company's objectives when managing capital are as follows:

- (i) to safeguard the Company's ability to continue as a going concern;
- (ii) to raise sufficient capital to finance its exploration and development activities on its Thor Lake Project;
- (iii) to raise sufficient capital to meet its general and administrative expenditures, and to explore and develop its other resource properties;

The Company manages its capital structure and makes adjustments to it, based on the general economic conditions, the Company's short term working capital requirements, and its planned exploration and development program expenditure requirements. The Company does not have any externally imposed capital requirements.

3. Financial Instruments

The Company has classified its financial instruments as follows:

<u>Financial Instrument</u>	<u>Classification</u>	<u>Accounting Treatment</u>
Cash and cash equivalents	Held for trading	Fair market value
Receivables	Loans and receivables	Amortized cost
Investments available for sale	Available-for-sale	Fair market value
Accounts payable	Other liabilities	Amortized cost

Cash and cash equivalents include bank deposits and highly liquid short term money market investments such as bankers acceptance notes, treasury bills and guaranteed investment certificates.

Investments available for sale ("Investments") consist of shares received as consideration for resource property interest. All Investments are in publicly traded companies.

The Company's risk exposures and the impact on the Company's financial instruments are summarized below:

Credit risk

The Company is not exposed to any significant credit risk as at February 28, 2009. The Company's cash and cash equivalents are either on deposit with a highly rated banking group in Canada or invested in bankers acceptance notes or guaranteed investment certificates issued by two highly rated Canadian banking groups.

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3. Financial Instruments (continued)

Liquidity risk

The Company has sufficient funds to cover its short term working capital requirements.

Market risk

(i) Interest rate risk

The Company has significant cash and cash equivalents balances and it has no interest-bearing debt. The Company's current policy is to invest its excess cash in highly liquid money market investments such as bankers acceptance notes, treasury bills and guaranteed investment certificates. These short term money market investments are subject to interest rate fluctuations.

(ii) Foreign currency risk

The Company's functional currency is primarily the Canadian dollar. The majority of the Company's purchases are transacted in Canadian dollars. As at February 28, 2009, the Company had US\$43,183 in cash.

(iii) Price risk

The prices of metals fluctuate widely and are affected by many factors outside of the Company's control. The prices of metals and future expectation of such prices have a significant impact on the market sentiment for investment in mining and mineral exploration companies. This in turn may impact the Company's ability to raise equity financing for its long term working capital requirements.

In addition, the values of the Company's Investments are subject market price fluctuations.

Sensitivity analysis

Based on management's knowledge and experiences of the financial markets, the Company's management believes the following movements are "reasonably possible" over a three month period.

As at February 28, 2009, approximately 60% of the Company's cash and cash equivalents are at fixed interest rates within the next three months. Sensitivity to a plus or minus 25 basis points change in rates would not have any significant effect on the Company's net loss over a three month period.

The Company had US\$43,183 in cash as at February 28, 2009 and its quarterly average expenditures transacted in US dollars is approximately US\$30,000. If the Canadian Dollar weakens or strengthens 10% against the United States Dollar with other variables held constant, the Company's net loss would not change significantly over a three month period.

A plus or minus 10% change in the market price of the Company's Investments would not have any significant effect on the Company's net loss.

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For the Six Months Ended February 28, 2009

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4. Resource Properties

For the Six Months ended February 28, 2009

	Separation Rapids Lithium- Tantalum Project	Warren Township Anorthosite Project	Thor Lake Rare Metals Project	Red Hill Copper- Zinc-Silver Project	East Kemptville Rare Metals Project	Total
Acquisition costs	\$ -	\$ -	\$ 590	\$ -	\$ -	\$ 590
Community consultation	-	1,925	77,846	-	-	79,771
Diamond drilling	-	-	1,293,886	-	-	1,293,886
Environmental studies/permitting	62,559	859	658,414	-	-	721,832
Feasibility/engineering studies	1,657	67	127,416	-	-	129,140
Geochemical	-	-	-	-	32,348	32,348
Geology	-	-	145,155	295	93,531	238,981
Geophysical	-	-	6,623	-	-	6,623
Metallurgical/market studies	41,644	3,850	500,342	-	1,856	547,692
Other	5,113	300	-	-	-	5,413
Current expenditures	110,973	7,001	2,810,272	295	127,735	3,056,276
Balance - August 31, 2008	3,713,949	1,185,805	7,281,767	598,264	408,841	13,188,626
Balance - February 28, 2009	\$ 3,824,922	\$ 1,192,806	\$ 10,092,039	\$ 598,559	\$ 536,576	\$ 16,244,902

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4. Resource Properties (continued)

For the Three Months ended February 28, 2009

	Separation Rapids Lithium- Tantalum Project	Warren Township Anorthosite Project	Thor Lake Rare Metals Project	Red Hill Copper- Zinc-Silver Project	East Kemptville Rare Metals Project	Total
Community consultation	\$ -	\$ 1,925	\$ 52,792	\$ -	\$ -	\$ 54,717
Diamond drilling	-	-	589,790	-	-	589,790
Environmental studies/permitting	26,034	859	149,147	-	-	176,040
Feasibility/engineering studies	-	-	37,224	-	-	37,224
Geochemical	-	-	-	-	13,079	13,079
Geology	-	-	61,798	-	17,057	78,855
Metallurgical/market studies	15,838	1,100	295,453	-	1,856	314,247
Other	5,113	300	-	-	-	5,413
Current expenditures	46,985	4,184	1,186,204	-	31,992	1,269,365
Balance – November 30, 2008	3,777,937	1,188,622	8,905,835	598,559	504,584	14,975,537
Balance - February 28, 2009	\$ 3,824,922	\$ 1,192,806	\$ 10,092,039	\$ 598,559	\$ 536,576	\$ 16,244,902

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5. Share Capital (continued)

The estimated fair value of the warrants totalled \$36,192. The fair value of the warrants was estimated at the issuance date based on the Black-Scholes pricing model, using the following assumptions:

Expected dividend yield	Nil
Risk-free interest rate	1.49%
Expected life	2.00 years
Expected volatility	96%

Warrant pricing models require the input of highly subjective assumptions including the expected price volatility. Changes in the subjective input assumptions can materially affect the fair value estimate and, therefore, the existing models do not necessarily provide a reliable measure of the fair value of the Company's warrants.

- ii) issued 502,500 non-flow-through common shares pursuant to the exercise of an equivalent number of stock options for cash proceeds of \$125,625. The estimated fair value at issuance of these options was \$63,717, and this amount has been added to the recorded value of the issued shares.

b) Common and Preferred Shares

The Company is presently authorized to issue an unlimited number of common shares without par value. The Company is also authorized to issue up to 25,000,000 preferred shares without par value, of which none have been issued.

c) Warrants

As at February 28, 2009 the following warrants were issued and outstanding:

- i) 3,805,000 non-flow-through warrants entitling the holder to purchase one common share at \$2.00 per share, expiring May 22, 2009; and
- ii) 198,750 non-flow-through warrants entitling the holder to purchase one common share at \$0.50 per share, expiring December 15, 2010.

During the six months ended February 28, 2009, share purchase warrants were issued, exercised or expired/cancelled as follows:

	Number of Warrants	Weighted Average Exercise Price
Balance - August 31, 2008	3,805,000	\$ 2.00
Issued	198,750	0.50
Balance - February 28, 2009	<u>4,003,750</u>	<u>\$ 1.93</u>

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5. Share Capital (continued)

d) Stock Option Plan

The shareholders have approved a Stock Option Plan (the "Plan") that provides for the issue of up to 10% of the number of issued and outstanding common shares of the Company to eligible employees, directors and service providers of the Company.

The Plan authorizes the granting of options to purchase shares of the Company's common stock at an option price equal to or greater than the closing price of the shares for either the trading day prior to the grant or the day of the grant. The options generally vest over a period of one to four years, and generally have a term of two to five years (but can have a maximum term of 10 years).

During the six months ended February 28, 2009, stock options were granted, exercised and expired/cancelled as follows:

	Number of Options	Weighted Average Exercise Price
Balance - August 31, 2008	4,327,500	\$ 1.13
Granted	1,132,000	0.71
Exercised	(502,500)	0.25
Expired/Cancelled	(325,000)	1.63
Balance – February 28, 2009	<u>4,632,000</u>	<u>\$ 1.09</u>
Vested options included in outstanding options above - February 28, 2009	<u>1,826,750</u>	<u>\$ 1.07</u>

During the six months ended February 28, 2009, the Company granted:

- i) 32,000 stock options to a consultant of the Company. Each option entitles the holder to purchase one common share of the Company at a price of \$1.86 per share until September 1, 2010. These options vest at the rate of 25% every three months following September 1, 2008. As at February 28, 2009, 16,000 options had been earned. The estimated fair value of these options totalled \$2,063 and this amount had been recorded as stock-based compensation expense.
- ii) 200,000 stock options to a consultant of the Company. Each option entitles the holder to purchase one common share of the Company at a price of \$0.50 per share until December 31, 2010. These options vest at the rate of 25% every three months following December 31, 2008. As at February 28, 2009, 33,333 options had been earned. The estimated fair value of these options totalled \$11,770 and this amount had been recorded as stock-based compensation expense.

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For the Six Months Ended February 28, 2009

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5. Share Capital (continued)

- iii) an aggregate of 200,000 stock options to three consultants of the Company. Each option entitles the holder to purchase one common share of the Company at a price of \$0.70 per share until January 13, 2011. These options vest at the rate of 25% every three months following January 13, 2009. As at February 28, 2009, 25,000 options had been earned. The estimated fair value of these options totalled \$9,646 and this amount had been recorded as stock-based compensation expense.
- iv) 50,000 stock options to a consultant of the Company. Each option entitles the holder to purchase one common share of the Company at a price of \$0.63 per share until January 27, 2011. These options vest at the rate of 25% every three months following January 27, 2009. As at February 28, 2009, 4,160 options had been earned. The estimated fair value of these options totalled \$1,348 and this amount had been recorded as stock-based compensation expense.
- v) 100,000 stock options to a new officer of Company. Each option entitles the holder to purchase one common share of the Company at a price of \$0.63 per share until January 27, 2014. These options vest at the rate of 25% every twelve months following January 27, 2009. The estimated fair value of these options totalled \$53,850 and this amount is being amortized and expensed as stock-based compensation over the vesting terms. As February 28, 2009, \$1,122 had been recognized and recorded as stock-based compensation expense.
- vi) an aggregate of 400,000 stock options to the Company's directors and officers. Each option entitles the holder to purchase one common share of the Company at a price of \$0.75 per share until February 13, 2014. These options vest at the rate of 25% every twelve months following February 13, 2009. The estimated fair value of these options totalled \$222,120 and this amount is being amortized and expensed as stock-based compensation over the vesting terms. As February 28, 2009, \$2,314 had been recognized and recorded as stock-based compensation expense.
- vii) an aggregate of 150,000 stock options to three consultants of the Company. Each option entitles the holder to purchase one common share of the Company at a price of \$0.75 per share until February 13, 2011. These options vest at the rate of 25% every three months following February 13, 2009. As at February 28, 2009, 6,240 options had been earned. The estimated fair value of these options totalled \$1,869, and this amount had been recorded as stock-based compensation expense.

During the six months ended February 28, 2009, the Company also recorded stock-based compensation expense of \$269,904 related to stock options with graded vesting schedules which were earned during the six months ended February 28, 2009.

The fair value of stock options to employees and directors was estimated at the grant date and the options to service providers were estimated at the service completion date based on the Black-Scholes pricing model, using the following weighted average assumptions:

Expected dividend yield	Nil
Risk-free interest rate	1.95%
Expected life	4.22 years
Expected volatility	97%

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5. Share Capital (continued)

Option pricing models require the input of highly subjective assumptions including the expected price volatility. Changes in the subjective input assumptions can materially affect the fair value estimate and, therefore, the existing models do not necessarily provide a reliable measure of the fair value of the Company's stock options.

As at February 28, 2009, the following options were vested and outstanding:

Option Price	Number of Options		Weighted Average Remaining Contractual Life
	Unvested	Vested	
\$ 1.86	24,000	8,000	1.5 years
\$ 1.82	168,750	56,250	3.7 years
\$ 1.80	62,500	37,500	2.4 years
\$ 1.61	375,000	375,000	2.3 years
\$ 1.24	200,000	-	4.1 years
\$ 1.20	675,000	275,000	3.1 years
\$ 1.08	-	150,000	2.3 years
\$ 0.98	200,000	200,000	2.8 years
\$ 0.80	-	300,000	2.6 years
\$ 0.75	550,000	-	4.1 years
\$ 0.70	200,000	-	1.9 years
\$ 0.69	-	200,000	2.0 years
\$ 0.63	150,000	-	3.9 years
\$ 0.50	200,000	-	1.8 years
\$ 0.48	-	225,000	1.7 years
	<u>2,805,250</u>	<u>1,826,750</u>	

e) Agents' Compensation Options

As at February 28, 2009, the Company had 725,000 Agents' Compensation Options issued and outstanding. Each Agent's Compensation Option entitles the agent holder to purchase one Unit at a price of \$1.55 per Unit, exercisable until November 22, 2009. Each Unit will consist of one common share and one-half of one common share purchase warrant. Each whole warrant entitles the holder to purchase one common share at an exercise price of \$2.00 per share until May 22, 2009. No warrants will be issued upon any exercise of the Agents' Compensation Options after May 22, 2009.

6. Contributed Surplus

Contributed surplus consists of expired warrants and options. The changes in contributed surplus during the six months ended February 28, 2009 are summarized as follows:

Balance - August 31, 2008	\$ 54,175
Options expired/cancelled	<u>163,644</u>
Balance - February 28, 2009	<u>\$ 217,819</u>

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7. Future Income Tax Recoveries

During the six months ended February 28, 2009, the Company issued 3,000,000 flow-through common shares for gross proceeds of \$1,500,000. Pursuant to the share subscription agreements, the Company is required to incur Canadian exploration expenses ("CEE") equal to the gross proceeds amount (of which \$724,348 has been incurred as at February 28, 2009) and the Company had renounced the CEE amount of \$1,500,000 to the investors with the effective date of December 31, 2008. The renunciation reduced the Company's future income tax assets by \$405,000. The Company accordingly reduced the share capital by the tax effect of \$405,000 at issuance. However, as the Company has not recognized its future income tax assets, the \$405,000 is recorded as a future income tax recovery on the statement of operations.

8. Related Party Transactions

During the six months ended February 28, 2009, the Company incurred:

- a) accounting fees of \$29,000 with an accounting firm in which an officer is the principal. As at February 28, 2009, accounts payable included \$10,000 accrued to this accounting firm;
- b) consulting fees of \$75,400 with a company owned by an officer of the Company, which were deferred as resource property costs. As at February 28, 2009, accounts payable included \$16,144 payable to this company; and
- c) consulting fees of \$20,350 with an officer of the Company, of which \$11,413 were deferred as resource property costs. As at February 28, 2009, accounts payable included \$10,054 payable to this officer.

9. Recent Accounting Pronouncements

Recent accounting pronouncements issued and not yet effective:

International Financial Reporting Standards ("IFRS")

The CICA plans to incorporate IFRS into the CICA Handbook as a replacement for current Canadian Generally Accepted Accounting Principles for most publicly accountable enterprises effectively for fiscal years beginning on or after January 1, 2011. The transition date of September 1, 2011 for the Company will require restatement for comparative purposes of amounts reported by the Company for the year ended August 31, 2010. While the Company has begun assessing the adoption of IFRS for 2011, the financial reporting impact of the transition to IFRS has not been determined at this time.